



# ***PCG 2024/D3 - Restructures and the new thin capitalisation and debt deduction creation rules - ATO compliance approach***

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## Draft Practical Compliance Guideline

# Restructures and the new thin capitalisation and debt deduction creation rules – ATO compliance approach

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- **Relying on this draft Guideline**

This Practical Compliance Guideline is a draft for consultation purposes only. When the final Guideline issues, it will have the following preamble:

*This Practical Compliance Guideline sets out a practical administration approach to assist taxpayers in complying with relevant tax laws. Provided you follow this Guideline in good faith, the Commissioner will administer the law in accordance with this approach.*

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### What this draft Guideline is about

1. This draft Guideline<sup>1</sup> has been prepared following the enactment of the *Treasury Laws Amendment (Making Multinationals Pay Their Fair Share—Integrity and Transparency) Act 2024* (the Act) on 8 April 2024. The Act introduces thin capitalisation rules in Division 820 of the *Income Tax Assessment Act 1997* (ITAA 1997) and the debt deduction creation rules (DDCR) in Subdivision 820-EAA of the ITAA 1997.

2. This Guideline primarily sets out our compliance approach to the restructures<sup>2</sup> carried out in response to the Act.

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<sup>1</sup> For readability, all further references to 'this Guideline' refer to the Guideline as it will read when finalised. Note that this Guideline will not take effect until finalised.

<sup>2</sup> The term 'restructure' encompasses any restructure or refinance, including any change, or reorganisation of group structure, business affairs or financial arrangements. Restructure includes any part of a broader restructure or a restructure that is part-way through and yet to be completed.

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3. This Guideline provides a risk assessment framework rating on the application of certain anti-avoidance provisions to restructuring in response to the Act.<sup>3</sup>
4. The risk assessment framework sets out matters that we will take into account in deciding whether or not we will have cause to devote our compliance resources to further examine your restructures. It does not mean that any anti-avoidance provision necessarily applies.
5. This Guideline does not replace, alter or affect our interpretation of the law in any way.
6. All legislative references in this Guideline are to the ITAA 1997, unless otherwise indicated.

### Structure of this Guideline

7. This Guideline is structured as follows:
  - the main body – which sets out the general principles of our risk approach and application of compliance resources and includes
    - a brief summary of relevant changes to the income tax laws in the Act
    - our compliance approach
    - our risk assessment framework
  - schedules – which expand on the principles in respect of specific examples.
8. Schedule 1 to this Guideline covers examples where the DDCR may need to be considered.
9. Schedule 2 to this Guideline covers the compliance risks arising from restructures in response to the DDCR. Some restructures in Schedule 2 to this Guideline build on examples in Schedule 1 to this Guideline and the 2 schedules to this Guideline should be read as complementary in considering whether to restructure your arrangements.
10. Schedule 3 to this Guideline will cover our view of risks arising from restructures in response to the introduced thin capitalisation rules. The Guideline will be updated to include Schedule 3 to this Guideline concurrently with the publication of the draft public ruling on the third party debt test (TPDT) which is currently under development.<sup>4</sup>
11. You will need to read and apply the schedules in conjunction with the general principles set out in the Guideline.

### Brief summary of changes in the Act

#### ***Thin capitalisation changes***

12. The Act introduced 3 thin capitalisation tests in Subdivision 820-AA for general class investors. These tests limit the amount of debt deductions of general class investors

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<sup>3</sup> The anti-avoidance provisions covered by this Guideline are Part IVA of the *Income Tax Assessment Act 1936* (ITAA 1936) and the specific anti-avoidance rule (SAAR) in section 820-423D.

<sup>4</sup> See item [4116] Thin capitalisation on the ATO website: [Advice under development – international issues](#).

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for an income year. The TPDT also applies to financial entities that are not an authorised deposit-taking institution (ADI)<sup>5</sup> in Subdivisions 820-B and 820-C.

13. The ‘fixed ratio test’ (FRT) disallows debt deductions where net debt deductions exceed 30% of the entity’s ‘tax EBITDA’. The FRT is the default test unless a choice to apply one of the other tests is made or is deemed to apply.

14. The ‘group ratio test’ can be used as an alternative to the FRT. This test limits net debt deductions using a ratio of the net interest expense and EBITDA of the worldwide group (of which the entity is a member) based on the worldwide group’s audited financial statements.

15. The TPDT limits an entity’s gross debt deductions to its ‘third-party earnings limit’. The ‘third-party earnings limit’ is broadly the sum of each debt deduction attributable to a debt interest issued by the entity that satisfies the third-party debt conditions in subsection 820-427A(3). Debt deductions attributable to any other debt interests (such as related party debt) do not count towards the ‘third-party earnings limit’.<sup>6</sup>

16. Debt deductions disallowed under the FRT over the previous 15 years may be utilised in a later year in certain circumstances, provided the entity continues to apply the FRT.<sup>7</sup> If an entity chooses to use the group ratio test or TPDT in a future year, the balance of any debt deductions that may be so utilised is reduced to nil.

### **Debt deduction creation rules**

17. The Act introduced the DDCR in Subdivision 820-EAA. The DDCR operates to disallow debt deductions arising on certain related party arrangements.

18. The DDCR applies to 2 types of arrangements.

#### **Type 1: acquisition case**

19. For Type 1 arrangements, the DDCR may disallow debt deductions where an entity (acquirer) acquires a CGT asset or a legal or equitable obligation from one or more associate pairs (each an associate disposer).

20. Type 1 rules apply to debt deductions of a ‘relevant entity’, which may be:

- the acquirer
- an associate pair of the acquirer (including an associate disposer)
- an associate pair of an associate disposer.<sup>8</sup>

21. The debt deductions must be:

- wholly or partly in relation to the acquisition or holding of the CGT asset, or legal or equitable obligation<sup>9</sup>
- referable to an amount paid or payable (directly or indirectly) to an associate pair of the relevant entity, acquirer or an associate disposer.<sup>10</sup>

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<sup>5</sup> An ADI entity is a body corporate that is an authorised deposit-taking institution for the purposes of the *Banking Act 1959*.

<sup>6</sup> Subsection 820-427A(1).

<sup>7</sup> Section 820-56.

<sup>8</sup> Paragraph 820-423A(2)(c).

<sup>9</sup> Paragraph 820-423A(2)(d).

<sup>10</sup> Paragraph 820-423A(2)(e).

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22. Type 1 rules apply to all acquisitions except acquisitions of:
- membership interests in an Australian entity or foreign company that have not previously been held by any entity<sup>11</sup>
  - a depreciating asset (other than an intangible asset) that the acquirer holds immediately after its acquisition and at the time of the acquisition
    - it is reasonable to conclude that the acquirer expects to use the CGT asset for a taxable purpose within Australia within 12 months
    - the CGT asset has not been installed ready for use, or previously used for a taxable purpose, by the acquirer, an associate disposer or an associate pair of the acquirer<sup>12</sup>
  - debt interests issued by an associate pair of the acquirer that have not previously been held by any entity.<sup>13</sup>
23. Debt deductions are disallowed to the extent that they are incurred in relation to the acquisition or holding of the CGT asset or legal or equitable obligation.<sup>14</sup>

***Type 2: payment or distribution case***

24. For Type 2 arrangements, the DDCR may disallow debt deductions where an entity (payer) uses a financial arrangement to fund, or facilitate the funding of, one or more relevant payments or distributions.

25. Type 2 rules apply to one or more payments or distributions that are:
- made to any entity ‘an associate recipient’ that is an associate pair of the payer
  - prescribed payments or distributions.<sup>15</sup>
26. The prescribed payments or distributions are:
- a dividend, distribution or non-share distribution
  - a distribution by a trustee or partnership
  - a return of capital, including a return of capital made by a distribution or payment made by a trustee or partnership
  - a payment or distribution in respect of the cancellation or redemption of a membership interest in an entity
  - a royalty, or a similar payment or distribution for the use of, or right to use, an asset
  - a payment or distribution that is wholly or partly referable to the repayment of principal under a debt interest if both of the following apply
    - the debt interest is issued by the payer, and
    - the debt interest is a financial arrangement that satisfies paragraphs 820-423A(5)(a), (b) and (c)

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<sup>11</sup> Subsection 820-423AA(1).

<sup>12</sup> Subsection 820-423AA(2).

<sup>13</sup> Subsection 820-423AA(3).

<sup>14</sup> Subsection 820-423B(1).

<sup>15</sup> Subparagraphs 820-423A(5)(b)(iii) and (iv).

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- a payment or distribution of a kind similar to a payment or distribution mentioned in the list points above
  - a payment or distribution prescribed by the regulations.<sup>16</sup>
27. Type 2 rules apply to debt deductions of a 'relevant entity', which may be:
- the payer
  - an associate pair of the payer (including an associate recipient)
  - an associate pair of an associate recipient.<sup>17</sup>
28. The debt deductions must be:
- wholly or partly in relation to the financial arrangement<sup>18</sup>
  - referable to an amount paid or payable (directly or indirectly) to an associate pair of the relevant entity, payer or an associate recipient.<sup>19</sup>
29. Debt deductions are disallowed to the same extent that the financial arrangement was used to fund, or facilitate the funding of, one or more prescribed payments or distributions made to an associate recipient.<sup>20</sup>

#### *Third party debt test choice*

30. Both Type 1 and Type 2 cases do not apply if the relevant entity has made a choice under subsection 820-46(4) to use the TPDT for the income year.<sup>21</sup>

#### *Indirect Type 1 and Type 2 arrangements*

31. Type 1 and Type 2 cases also apply to indirect arrangements.<sup>22</sup>
32. In the case of Type 1 arrangements, the DDCR may apply in relation to an indirect acquisition by an entity through one or more interposed entities.<sup>23</sup> In determining whether an acquisition occurs indirectly through one or more interposed entities, it is sufficient if acquisitions exist between each entity and it is not necessary that these occur in series.
33. A Type 1 indirect acquisition through one or more interposed entities may occur even if an acquisition in the series is covered by the exceptions in section 820-423AA.
34. In the case of Type 2 arrangements, the relevant prescribed payments of distributions may be made directly, or indirectly through one or more interposed entities before, at, or after the time the relevant payer enters into or has the financial arrangement which funds or facilitated the funding of those payments or distributions. The recipient may be the entity that the payer has the financial arrangement with, or another entity.<sup>24</sup>
35. In determining whether a payment or distribution is made indirectly through one or more interposed entities, it is sufficient if payments exist between each interposed entity,

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<sup>16</sup> Subsection 820-423A(5A).

<sup>17</sup> Paragraph 820-423A(5)(c).

<sup>18</sup> Paragraph 820-423A(2)(d).

<sup>19</sup> Paragraph 820-423A(2)(e).

<sup>20</sup> Subsection 820-423B(2).

<sup>21</sup> Paragraphs 820-423A(2)(g) and 820-423A(5)(f).

<sup>22</sup> Paragraph 820-423A(2)(a), subsections 820-423A(3A) and (6).

<sup>23</sup> Paragraph 820-423A(3A)(a).

<sup>24</sup> Paragraphs 820-423A(6)(a) and (b).

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and it is not necessary to demonstrate that each payment in a series of payments funds the next payment, or is made after the previous payment.<sup>25</sup>

#### *Associate pairs*

36. An entity is an associate pair of another entity if either or both of the following conditions are met:

- the entity is an associate of the other entity, or
- the other entity is an associate of the entity.<sup>26</sup>

#### *Section 820-37 does not apply to the debt deduction creation rules*

37. An entity that satisfies section 820-37 will still need to apply the DDCR.

38. Section 820-37 generally operates so that the thin capitalisation rules will not apply to an entity for an income year if that entity meets the assets threshold (known as the 90% Australian assets threshold).

39. Section 820-37 only applies to:

- outward investing financial entities (non-ADI) and outward investing entities (ADI) that are not also an inward investing financial entity (non-ADI) or inward investing entity (ADI).
- general class investors that would meet the above condition (if they were financial entities).

#### *Application of the debt deduction creation rules*

40. The DDCR applies to assessments for income years that commence on or after 1 July 2024.

41. Accordingly, the DDCR applies in relation to:

- arrangements entered into before 1 July 2024 if debt deductions continue to arise from the historical arrangements in income years commencing on or after 1 July 2024.
- new arrangements entered into on or after 1 July 2024.

#### *Specific anti-avoidance rule in section 820-423D*

42. Section 820-423D contains the DDCR specific anti-avoidance rule (SAAR) which directly targets schemes entered into to avoid the operation of the DDCR. For the DDCR SAAR to apply, the following criteria must be satisfied:

- it is reasonable to conclude that one or more entities entered into or carried out a scheme for the principal purpose of, or for more than one principal purpose that included the purpose of, achieving any of the following results
  - subsection 820-423A(2) does not apply in relation to a debt deduction

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<sup>25</sup> Paragraphs 820-423A(7)(a) and (b).

<sup>26</sup> Subsection 995-1(1).



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- subsection 820-423A(5) does not apply in relation to a debt deduction  
(whether or not the debt deduction is a debt deduction of any of the participants and whether or not any of them carried out the scheme or any part of the scheme), and
- the scheme has achieved, or apart from this section would achieve, that purpose.

43. Paragraphs 1.43 and 1.44 of the Supplementary Explanatory Memorandum to the Treasury Laws Amendment (Making Multinationals Pay Their Fair Share—Integrity and Transparency) Bill 2023 relevantly states the following regarding the intended operation of section 820-423D:

1.43 Schemes that seek to exploit the related party debt deduction condition to artificially locate or ‘debt-dump’ third-party debt in Australia will be subject to the anti-avoidance rules in section 820-423D and Part IVA of the ITAA 1936. For example, such schemes may involve third party debt (and the associated debt deductions) being located in Australia, whilst the proceeds of the debt are ultimately used for business activities outside Australia. Such schemes may have a sophisticated commercial guise or may be embedded into genuine commercial activity.

1.44 The anti-avoidance rules in section 820-423D may also apply to any avoidance schemes relating to the debt deduction creation rules. However, these rules are not intended to apply to schemes where a taxpayer is merely restructuring, without any associated artificiality or contrivance, out of an arrangement that would otherwise be caught by the debt deduction creation rules. The application of section 820-423D will ultimately depend on the facts and circumstances of each case.

#### **Date of effect**

44. When finalised, this Guideline applies to restructures entered into on or after 22 June 2023 (the date the Act was introduced into parliament).

#### **Compliance approach**

45. It is recognised that the Act will result in different tax outcomes as compared to the previous thin capitalisation rules. We expect taxpayers will need to consider the impact of these changes on their affairs and whether it is appropriate to restructure their arrangements that give rise to debt deductions.

46. This Guideline sets out our compliance approach to restructures by providing a risk assessment framework. You can assess the risks associated with restructuring in response to the DDCR in accordance with this Guideline.

47. By following this Guideline, you can understand the compliance risks associated with restructures being contemplated or already undertaken. If your restructures are low risk you can have confidence that we will not allocate resources to intensive examinations beyond verifying your self-assessment. Similarly, it provides certainty on areas of higher compliance risk that are likely to result in further and more intensive examinations.

48. As our engagement with affected taxpayers and our compliance activity increases throughout the implementation of the Act, this Guideline may be updated. We will consult on any proposed material changes.

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**Risk assessment framework**

49. Where taxpayers restructure in response to the Act, we will also consider the application of the DDCR SAAR or Part IVA of the ITAA 1936 (concurrently with other provisions of the income tax law).

50. This risk assessment framework is designed to explain how to assess the compliance risks of your restructuring with respect to the Act. If you have not undertaken a restructure in response to the DDCR in an income year, this risk assessment framework does not apply to you.

51. Your risk rating will influence our engagements with you, including the intensity of assurance activities or whether we are likely to engage with you to review your restructure. We generally prioritise our resources and undertake more intensive investigations to address higher risk restructuring.

**Table 1: Risk assessment framework**

Risk zone	Risk level
White	Further risk assessment not required
Yellow	Compliance risk not assessed
Green	Low risk
Red	High risk

52. As we continue to implement the DDCR, we expect to revisit these zones to ensure that they continue to be an accurate reflection of the Commissioner's understanding of the risks associated with such restructures. We will consult on any proposed material changes.

**White zone**

53. You are in the white zone if all of your restructures in response to the DDCR are in the following categories:

- There is a settlement agreement between you and the ATO entered into since enactment of the Act on 8 April 2024, where the terms of the settlement cover the Australian tax outcomes including under the DDCR related to the arrangement for the current year, and you have met the conditions of the agreement.
- There is a court decision in relation to the Australian tax outcomes of the arrangement including under the DDCR, where you were a party to the proceeding.

54. Your restructure will be in the white zone as long as there has not been a material change in the arrangement since the time of the agreement or decision.

55. If your restructure is in the white zone, you do not need to apply the risk assessment framework. We will not have cause to apply compliance resources beyond verifying that you can substantiate that the conditions for white zone have been met.

56. It is not anticipated that many taxpayers will have restructures in the white zone early in the implementation of the Act.

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### **Yellow zone**

57. You are in the yellow zone if you have undertaken one or more restructures (including any part of a restructure) in response to the DDCR in the income year that are not in the green or red zones. That is, restructures that are not covered by examples in Schedule 2 to this Guideline.

58. If your restructure is in the yellow zone, we may engage with you to understand the compliance risks of your restructure.

### **Green zone**

59. You are in the green zone if all of your restructures in response to the DDCR are in the following categories:

- Your restructure in response to the DDCR in the income year is
  - covered by low-risk examples in Schedule 2 to this Guideline, and
  - exhibit the features set out in paragraph 166 of this Guideline.
- We have conducted a review or audit of your restructure and
  - provided you with a ‘low-risk’ rating (or ‘high assurance’ under a Justified Trust review), and
  - there has not been a material change in the arrangement which informed the basis of our risk or assurance rating in the review or audit.

60. If your restructure is in the green zone, we will generally only have cause to devote our compliance resources to tax risks in scope of this Guideline to obtain comfort and verify your self-assessment.

### **Red zone**

61. You are in the red zone if any of your restructures in response to the DDCR are in the following categories:

- Your restructure (including any part of a restructure) in response to the DDCR in the income year is covered by a high-risk examples in Schedule 2 to this Guideline.
- We have conducted a review or audit of your restructure and provided you with a ‘high risk’ rating (or ‘low assurance’ under a Justified Trust review).

62. If your restructure is in the red zone, we will prioritise our resources to review your arrangement. This may involve commencing a review or audit. The red zone is a reflection of the features that we consider indicate greater risk; however, it is not a presumption that the DDCR SAAR or Part IVA of the ITAA 1936 necessarily apply.

63. We will generally tell you if we intend to commence an examination involving the DDCR SAAR or Part IVA of the ITAA 1936. As part of our examination, we will consider information available to us and may request further information from you. We will have regard to the relevant facts and circumstances, including evidence in relation to contended commercial or non-tax rationales, when we review your restructure.

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## ***Reporting your self-assessment***

64. It is generally voluntary to apply this Guideline to assess your restructures, although doing so is best practice. If you do not apply this Guideline, we may apply resources to understand your arrangements consistent with the red zone.

65. You may be required to report your risk rating. For example, you may have disclosure requirements if you are required to complete a reportable tax position schedule.

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**Commissioner of Taxation**

9 October 2024

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Status: **draft only – for comment****SCHEDULE 1 – Debt deduction creation rules****Scope of this Schedule**

66. The DDCR applies to debt deductions arising in income years starting on or after 1 July 2024, regardless of whether those debt deductions are connected to arrangements arising prior to, or after, the start of such an income year.

67. This Schedule provides you with guidance on:

- examples where the DDCR may need to be considered
- records and evidence relevant to such considerations, including tracing and apportionment of funds.

68. The examples in this Schedule provide guidance to assist taxpayers considering whether to restructure. The examples do not consider the DDCR SAAR or any other provision.

69. Schedule 2 to this Guideline provides examples of restructures in response to the DDCR, some of which build on the examples in this Schedule.

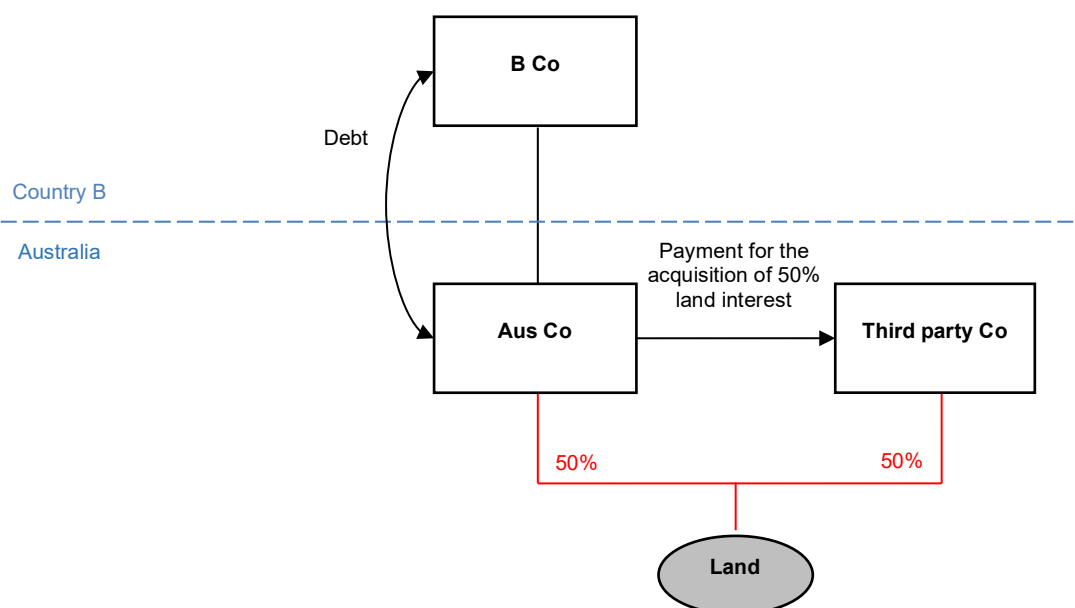
**Examples where the debt deduction creation rules may need to be considered**

70. The DDCR may need to be considered in the following examples. In each example, information and documentation would need to be obtained where the taxpayer wants to determine if the DDCR (and whether any of the exceptions in section 820-423AA) applies to the arrangement.

71. If the DDCR needs to be considered, in the course of compliance activity we would ordinarily expect to allocate resources to ensure that the correct amount of debt deductions were disallowed.

**Example 1 – timing and the ‘associate pairs’ conditions**

*Diagram 1: Timing and the ‘associate pairs’ conditions*



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72. *Aus Co is an Australian tax resident and general class investor wholly owned by B Co, which is a tax resident of Country B.*

73. *Aus Co acquires a 50% interest in land from Third Party Co, an unrelated Australian company. Aus Co borrows from B Co to fund the acquisition of its 50% interest in the land.*

74. *Aus Co and Third Party Co hold their respective shares in the land as tenants in common.*

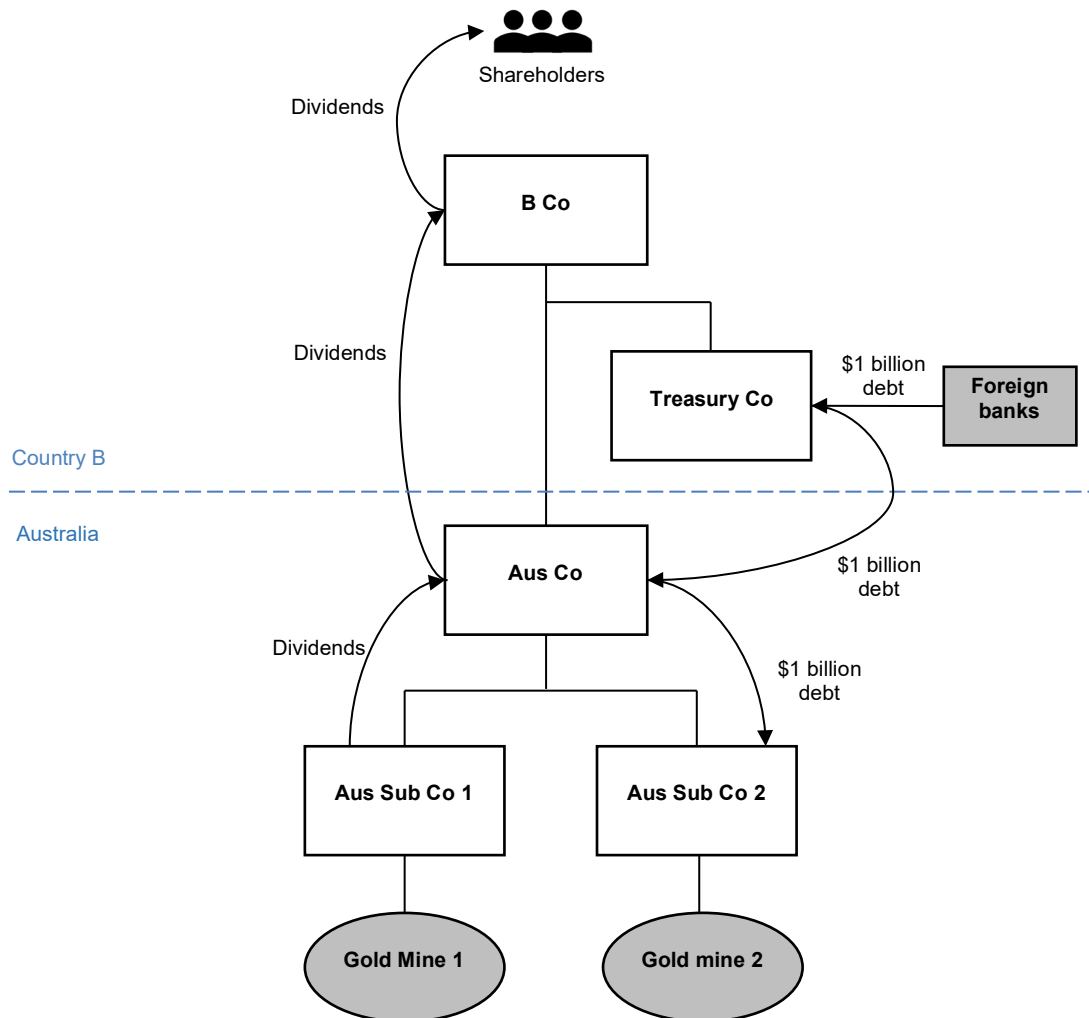
75. *Aus Co and Third Party Co subsequently enter into a joint venture arrangement to develop the land for residential purposes. Aus Co and Third Party Co become associate pairs.*

76. *Aus Co will not need to consider the application of the DDCR for this arrangement as Aus Co and Third Party Co were not associate pairs at the time Aus Co acquired its interest in the land from Third Party Co. We are unlikely to apply compliance resources in this example.*

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**Example 2 – funding capital expenditure only with related party debt***Diagram 2: Funding capital expenditure only with related party debt*

77. Aus Co is an Australian tax resident and general class investor that is a holding company with 2 Australian subsidiaries (Aus Sub Co 1 and Aus Sub Co 2).

78. Aus Co is a subsidiary of B Co, a multinational enterprise which is tax resident in Country B.

79. Aus Sub Co 1 owns and operates a gold mine in Australia (Gold Mine 1). It does not have any borrowings and regularly pays dividends to Aus Co from its retained earnings. In turn, Aus Co regularly pays dividends to B Co.

80. The Board of B Co resolves to use Aus Sub Co 2 to mine gold in Australia from a separate mining lease (Gold Mine 2) recently acquired from an unrelated third party.

81. Aus Sub Co 2 does not carry on any other business.

82. B Co's subsidiary Treasury Co, which is resident in Country B, issues \$1 billion of interest-bearing debt interests to foreign banks for the specific purpose of funding Gold

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*Mine 2's development. The borrowed funds are lent through Aus Co to Aus Sub Co 2 on back-to-back terms. Aus Co has no other borrowings.*

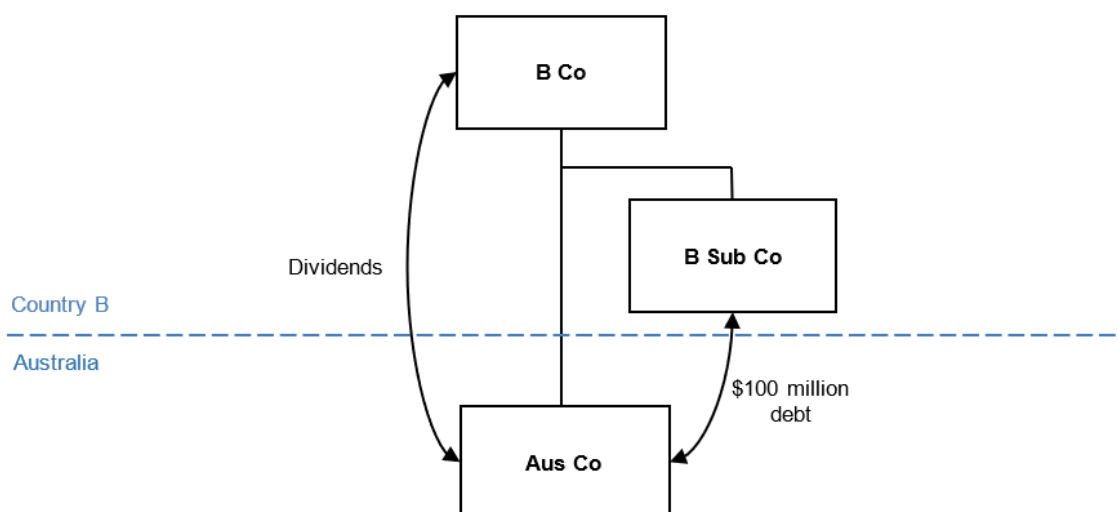
83. *While Gold Mine 2 is in development:*

- *Aus Sub Co 2 does not pay dividends to Aus Co.*
- *Aus Sub Co 1 continues to pay regular dividends to Aus Co from its retained earnings and in turn Aus Co continues to pay regular dividends of a similar amount to B Co.*

84. *Aus Co would not need to consider the application of the DDCR while Gold Mine 2 is in development, as Aus Co's borrowings are not used to fund or facilitate the funding of any dividends. We are unlikely to apply compliance resources while Gold Mine 2 is in development to determine the application of the DDCR.*

### **Example 3 – funding working capital and dividends with related party debt**

Diagram 3: Funding working capital and dividends with related party debt



85. *Aus Co is an Australian tax resident and a subsidiary of B Co, a multinational enterprise which is tax resident in Country B. B Co runs a global motor vehicle sales business.*

86. *Aus Co carries on the multinational enterprise's business operations in Australia. It regularly pays dividends to B Co out of profits generated from the sales of motor vehicles to Australian customers.*

87. *In a particular year, Australian profits are not sufficient for Aus Co to fund dividends and its continuing operations.*

88. *Aus Co issues a \$100 million debt interest to B Sub Co, a subsidiary of B Co which is tax resident in Country B. The funds raised under the debt interest are used by Aus Co to pay a dividend to B Co and to fund its commercial operations.*

89. *Aus Co will need to consider the application of the DDCR for the extent to which the financial arrangement funded or facilitated the funding of the dividends to B Co. We are*



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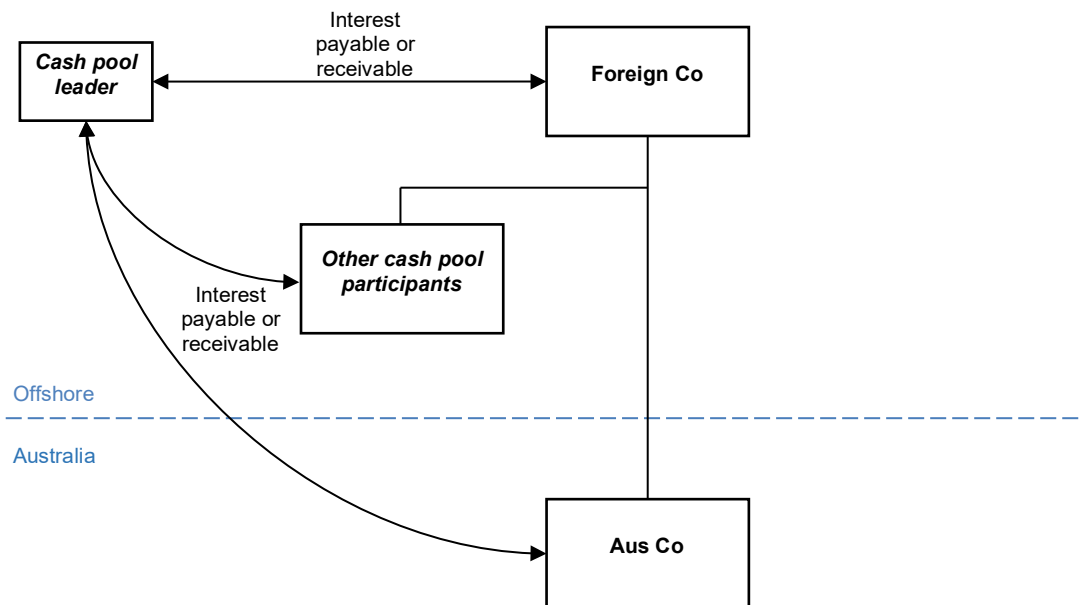
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*likely to consider applying compliance resources to determine the correct application of the DDCR.*

#### **Example 4 – cash pooling**

Diagram 4: Cash pooling



90. *Aus Co is an Australian company with a foreign parent, Foreign Co.*

91. *Foreign Co operates a global cash pooling arrangement with numerous offshore cash pool participants and an offshore cash pool leader. The arrangement requires all accounts to be nil, with positive balances transferred (or 'swept') to the cash pool leader and negative balances replenished by the cash pool leader daily.*

92. *If a participant has its cash swept to the offshore cash pool leader, the leader will pay interest on the balance owed to the participant at a rate determined under the arrangement.*

93. *If a participant is transferred an amount from the offshore cash pool leader in order to make its account balance nil, unless any amount is owed by the leader, the participant will pay interest on the balance owed to the leader.*

94. *Aus Co has no other borrowings.*

95. *Aus Co uses its cash pool account to acquire CGT assets from associate pairs and to fund dividends, royalties and returns of capital to associate pairs.*

96. *Throughout the 2023–24 income year, Aus Co's cash pool balance always remains positive. In the 2024–25 income year, Aus Co's balance fluctuates between negative and positive.*

97. *Aus Co does not need to consider the application of the DDCR in relation to the 2023–24 income year as Aus Co's cash pooling account did not give rise to debt deductions and we are unlikely to apply compliance resources in this example.*

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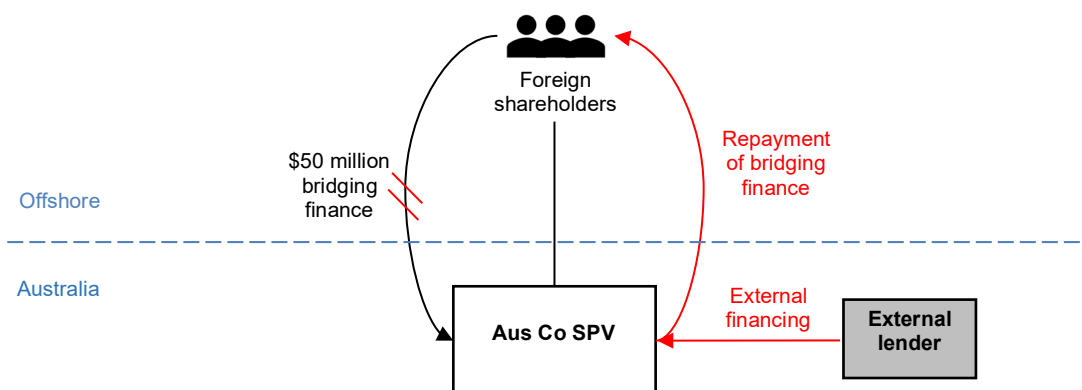
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98. However, Aus Co does need to consider the application of the DDCR to the debt deductions arising in the 2024–25 income year and we are likely to consider applying compliance resources to verify the correct application of the DDCR for this year.

### **Example 5 – bridging finance**

Diagram 5: Bridging finance

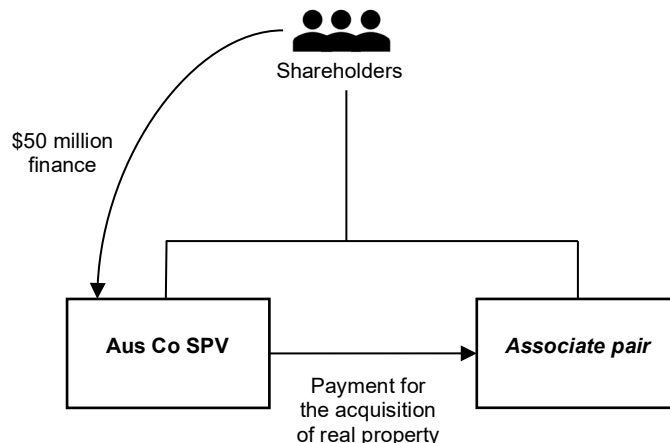


99. Aus Co SPV is an Australian incorporated entity and general class investor. It is commencing a new project in Australia for which capital expenditure is forecast to be approximately \$300 million.

100. Due to commercial issues causing delays in external funding, \$50 million bridging finance is obtained from the SPV's shareholders to make initial capital acquisitions. None of the initial capital acquisitions are covered by subsection 820-423A(2).

101. Once external finance is obtained, Aus Co SPV repays the \$50 million shareholder bridging finance with the proceeds of the external financing.

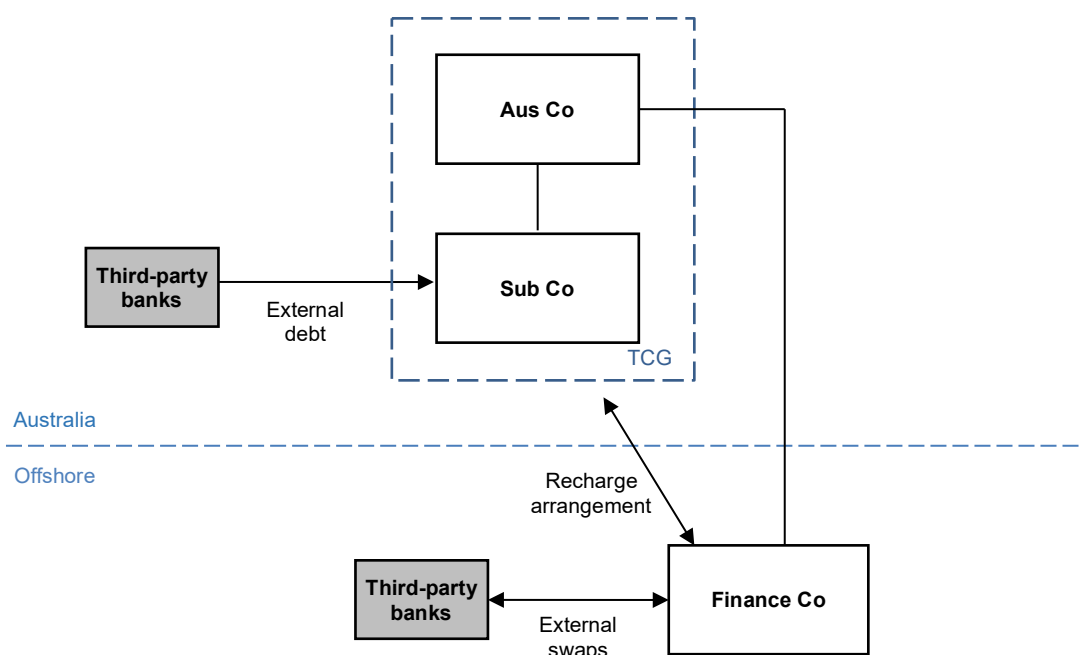
102. Aus Co will not need to consider the DDCR as no related party debt deductions arise in relation to acquisitions from associate pairs. We are unlikely to apply compliance resources in this example to determine the application of the DDCR.

Status: **draft only – for comment****Example 6 – related party financing of related party acquisition***Diagram 6: Related party financing of related party acquisition*

103. *Aus Co SPV is an Australian incorporated entity and general class investor. It commences a new property project in Australia and acquires real property from an associate pair for approximately \$300 million.*

104. *Debt interests of \$50 million in total were issued by Aus Co SPV to SPV's shareholders which are an associate pair in relation to Aus Co SPV.*

105. *Aus Co SPV will need to consider the application of the DDCR to debt deductions arising in relation to the \$50 million associate pair financing. We are likely to consider applying compliance resources to determine the correct application of the DDCR.*

**Example 7 – related party transactions to recharge outcomes arising from swaps***Diagram 7: Related party transactions to recharge outcomes arising from swaps*

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Status: **draft only – for comment**


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106. *Aus Co is a general class investor and the head company of an Australian tax consolidated group. The group raises debt financing by issuing debt interests to third-party banks to fund its commercial activities (which does not include any acquisitions from associate pairs or payments to associate pairs).*

107. *The bank debt is denominated in various currencies at fixed rates. To manage the associated interest rate and exchange rate risks, the group enters into interest rate swaps (IRS) and cross currency interest rate swaps when it issues the debt interests to the third-party banks in order to convert the group's fixed interest rate exposure under the debt to floating US dollar interest rate exposure.*

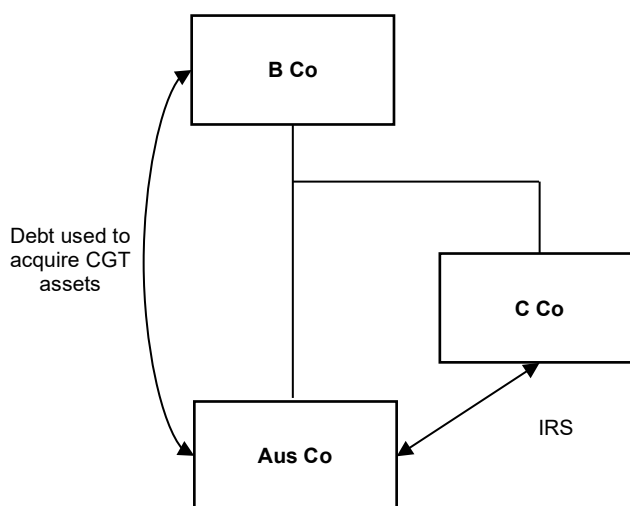
108. *A related party (not within the tax consolidated group), Finance Co, undertakes all swap transactions for the group. It executes the swaps under International Swaps and Derivates Association agreements with third-party banks.*

109. *When entering into these swaps, Finance Co and Aus Co also enter into internal arrangements which recharge or pass through the actual costs and payments of the external bank swaps to Aus Co which effectively hedge the bank debt. The recharge costs are debt deductions.*

110. *Aus Co will not need to consider the DDCR for this arrangement as the debt deductions in relation to the recharge arrangement are not in relation to a transaction with an associate pair. We are unlikely to apply compliance resources in this example to determine the application of the DDCR.*

### **Example 8 – debt deductions in relation to an acquisition from an associate pair**

Diagram 8: Debt deductions in relation to an acquisition from an associate pair



111. *Aus Co is an Australian tax resident and general class investor.*

112. *Aus Co acquires a CGT asset directly from B Co (an associate pair). The acquisition is not covered by section 820-423AA.*

113. *Aus Co finances the acquisition with an interest-bearing loan from B Co of \$100 million.*

114. *In order to swap its exposure to interest rate risk in relation to the loan, Aus Co enters into an IRS with another associate pair, C Co.*

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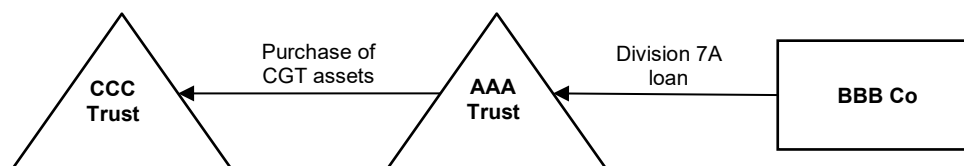
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115. *Aus Co would need to consider the application of the DDCR to the debt deductions in relation to the loan and the interest rate swap. We are likely to consider applying compliance resources to determine the correct application of the DDCR.*

### **Example 9 – acquisition from a related trust**

Diagram 9: Acquisition from a related trust



116. *AAA Trust is a general class investor. AAA Trust is carrying on a business and, together with its associates, has more than \$2 million in debt deductions.*

117. *BBB Co is a private company that holds a significant amount of funds in the group.*

118. *CCC Trust is a trust that holds a CGT asset.*

119. *AAA Trust, BBB Co and CCC Trust are part of a privately owned group and are associate pairs of each other.*

120. *In the 2024–25 income year, the trustee of the AAA Trust acquired the CGT asset held by CCC Trust to be used in its business.*

121. *AAA Trust did not have sufficient working capital to both acquire the CGT asset and fund its business operations.*

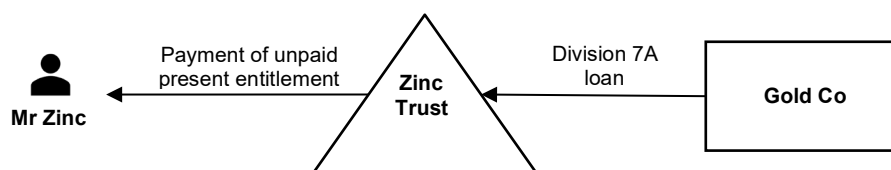
122. *The trustee of AAA Trust and BBB Co entered into a Division 7A (of the ITAA 1936) complying loan agreement<sup>27</sup> under which the trustee borrowed an amount from BBB Co equal to the amount of the CGT asset's purchase price (Division 7A complying loan). The loan agreement stipulates that the trustee of AAA Trust must make minimum yearly repayments to BBB Co, and the rate of interest payable on the loan is equal to the benchmark interest rate for each year.*

123. *The trustee of AAA trust pays the CCC Trust the purchase price for the CGT asset using the funds provided under the Division 7A complying loan for the CGT asset acquired.*

124. *The trustee of AAA trust will need to consider the application of the DDCR to the debt deductions arising in relation to the acquisition from CCC Trust. We are likely to consider applying compliance resources to determine the correct application of the DDCR.*

### **Example 10 – loan funding distribution by trustee**

Diagram 10: Loan funding distribution by trustee




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<sup>27</sup> See section 109N of Division 7A of the ITAA 1936.

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125. *Zinc Trust is a discretionary trust and a general class investor that, together with its associates, has more than \$2 million in debt deductions.*

126. *Mr Zinc is the appointor and primary beneficiary of Zinc Trust.*

127. *Gold Co is a private company of which Mr Zinc is the sole director and shareholder.*

128. *The 2 entities are part of a privately owned group and are associate pairs of each other.*

129. *In the 2021–22 income year, the trustee of Zinc Trust made Mr Zinc presently entitled to 100% of the trust income. Mr Zinc agreed for the trustee to retain the amount to which his present entitlement relates in Zinc Trust as working capital.*

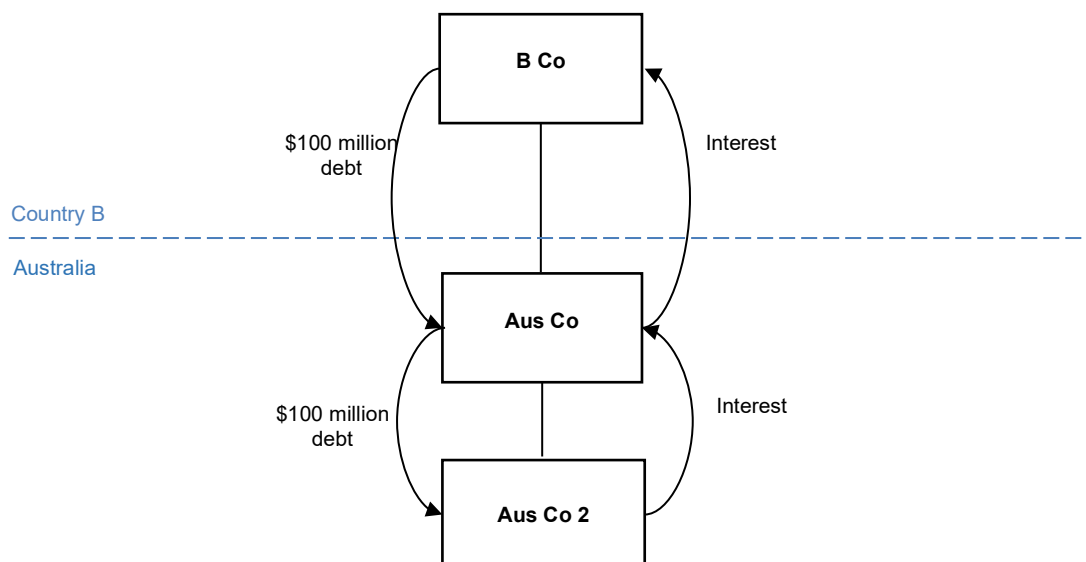
130. *On 30 June 2023, Mr Zinc called for payment of his unpaid present entitlement (UPE). After reviewing the financial affairs of the Zinc Trust, the trustee decided to refinance the amount contributed by Mr Zinc by borrowing the same amount from Gold Co rather than reducing the working capital of the business. The loan was structured in accordance with Division 7A of the ITAA 1936 complying terms. The rate of interest payable on the loan from Gold Co is equal to the benchmark interest rate for each year.*

131. *The trustee used the amount borrowed from Gold Co to pay off Mr Zinc's UPE.*

132. *The trustee will need to consider the application of the DDCR to Zinc Trust's debt deductions arising in relation to the borrowing from Gold Co used to fund or facilitate the funding of the payment of Mr Zinc's UPE. We are likely to consider applying compliance resources to determine the correct application of the DDCR.*

### **Example 11 – related party lending between multinational subsidiaries**

Diagram 11: Related party lending between multinational subsidiaries



133. *Aus Co is an Australian tax resident and general class investor, wholly owned by B Co, a tax resident of Country B. Aus Co issued a \$100 million debt interest to B Co.*

134. *Using the proceeds of the debt interest, Aus Co acquires a \$100 million debt interest from Aus Co 2, another wholly owned subsidiary of B Co and Australian tax resident. No other entity has previously held the debt interest.*

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135. *Aus Co 2 uses the proceeds to acquire CGT assets from unrelated entities in the ordinary course of its commercial operations.*

136. *Aus Co and Aus Co 2 will not need to consider the application of the DDCR for this arrangement as no related party debt deductions arise in relation to transactions with associate pairs other than the debt interests that are covered by the exception in subsection 820-423AA(2). We are unlikely to apply compliance resources in this example.*

137. *Aus Co and Aus Co 2 will need to consider the application of the DDCR to their respective debt deductions in relation to any other transactions Aus Co 2 enters with associate pairs, including whether those transactions were indirectly made by Aus Co. Where such transactions occur, we are likely to consider applying compliance resources to determine the correct application of the DDCR.*

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#### **Debt deduction creation rules records and evidence**

138. The DDCR requires taxpayers to trace the use of debt funding transactions that are covered by subsections 820-423A(2) and (5), including both direct and indirect transactions.

139. In order to determine whether the DDCR has application to your arrangements, you and your associate pairs will need to obtain sufficient information to trace the use of related party debt and whether it funds transactions that are covered by subsections 820-423A(2) and (5), including both direct and indirect transactions. For example, the information should be sufficient to establish whether an arrangement has the characteristics of the examples in this Guideline.

#### **Historical transactions**

140. Stakeholders have raised practical concerns when seeking to comply with the DDCR where business records about historical transactions and related party debt may be limited.

141. We recognise that it can be challenging to obtain relevant documents and information to evidence or substantiate use of related party debt funding for historical transactions.

142. We anticipate that the following documents and information may assist taxpayers to demonstrate whether the DDCR applies to debt deductions in relation to your historical transactions:

- copies of loan documentation prepared when the related party debt was entered into or dealt with (for example, intercompany loan agreements or other documents setting out the purpose of the loan and key terms).
- copies of the taxpayer's and relevant associate pair's financial accounts for the relevant years, prepared in accordance with accounting principles, and any records or working papers prepared by the taxpayer or their professional advisers, for example, accounting or tax working papers.
- copies of cash flow statements, general ledger, journals or other records or working papers with identifiable entries relating to historical transactions and related party debt.
- copies of bank statements or payment records.

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- copies of board minutes, resolutions and papers, or any other contemporaneous documentation relating to the decisions to undertake historical transactions or enter into related party debt.

143. However, the onus is on the taxpayer to prove that the DDCR does not apply and you can prove this through the provision of information and documentation to us.

144. Stakeholders have requested that we not allocate compliance resources to ongoing related party funding of historical transactions that occurred before a certain period (for example, more than 5 years before enactment). We do not consider such an approach is available and appropriate. We will assist taxpayers seeking to comply with the DDCR.

145. All information and documentation provided to us should be in English or be accompanied with an English translation.

146. In the course of the ATO's compliance activities, we may request these documents or similar information from you as evidence of relevant tracing.

147. Where the onus to prove that the DDCR does not apply to you is not discharged, we may have cause to apply compliance resources to determine whether the correct amount of debt deductions have been disallowed under subsection 820-423A(1).

#### ***Transactions since enactment***

148. Since the enactment of the DDCR, best practice record-keeping practices have changed. We would expect taxpayers to keep contemporaneous documentation and associated analysis on the operation of the DDCR (including evidentiary support for tracing the use of funds).

149. We also expect associate pairs to provide taxpayers with full disclosure of all relevant information to work out whether the DDCR applies to debt deductions in relation to transactions covered by subsections 820-423A(2) and (5), including for indirect arrangements.

150. A deduction should not be claimed unless sufficient information is available to support a conclusion that the DDCR does not apply.

#### ***Tracing of funds and apportionment***

151. Stakeholders have requested guidance on methodologies to trace and apportion the disallowance of debt deductions under subsection 820-423A(1).

#### ***Tracing of funds***

152. We consider that tracing is a factual exercise and should be the method used to determine the disallowed debt deduction under subsection 820-423A(1) wherever possible.

#### ***Apportionment***

153. Apportionment does not replace tracing. However, apportionment may be appropriate where it is not possible to trace, such as where funds from various sources that were used for different purposes are combined into a single debt interest.



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154. Whether an apportionment methodology is appropriate will depend on whether it is fair and reasonable in the relevant facts and circumstances.

155. An example of fair and reasonable apportionment is where the debt deductions under a facility are disallowed in the same proportion of the 'DDCR debt' to total debt in circumstances where related party debt that funded transactions covered by subsections 820-423A(2) or (5) is refinanced into a single related party debt facility that also includes debt in relation to other purposes. This includes any repayments of principal and capitalisation of interest.

156. We are aware of potential methodologies, including:

- methodologies that rely on a hypothesis of what may instead have occurred had the DDCR been in operation at the time
- methodologies that allocate historical principal repayments (including those made prior to the enactment of the DDCR) to any debt or part of a debt that may give rise to disallowance under the DDCR, and allocating principal repayments to other debt after the DDCR debt portion has first been treated as repaid without contemporaneous documentation to support that allocation.

157. We do not consider such approaches are designed to provide a fair and reasonable apportionment as they do not reflect the facts and circumstances of taxpayers' affairs. We would apply compliance resources to investigate any such apportionment approach.

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## **SCHEDULE 2 – Restructures in response to the debt deduction creation rules**

### **Scope of this Schedule**

158. The Schedule provides our view on the compliance risks associated with restructures in response to the DDCR.

159. The risk assessment framework in this Guideline applies to the restructuring examples in this Schedule.

160. Concerns have been raised about the potential for us to apply the DDCR or Part IVA of the ITAA 1936 to cancel all or part of a tax benefit where a taxpayer restructures to avoid the application of the DDCR but preserves tax benefits going forward, such as debt deductions arising in relation to transactions covered by subsections 820-423A(2) or (5).

161. For example, replacing a debt interest to an associate pair with a debt interest to an unrelated entity to eliminate related party debt deductions with other debt deductions.

162. This Schedule provides examples of restructures that we consider to be low risk restructures and high risk restructures. Many of these examples build on examples in Schedule 1 to this Guideline and the 2 schedules should be read as complementary.

### **Low risk restructures**

163. We expect the lowest risk restructures to involve the repayment of all related party debt in relation to transactions covered by subsections 820-423A(2) or (5) without any additional debt being issued or acquired. That is, by eliminating all debt deductions that would otherwise be disallowed under subsection 820-423A(1).

164. Some of the following examples involve the repayment of related party debt without additional debt being introduced. Others involve the introduction of new debt.

165. Where a restructure is low risk, we will generally allocate compliance resources only to obtain comfort and verify your self-assessment.

166. Restructures are only low risk where the arrangements are otherwise commercial. The following features must be present for a restructure to be low risk:

- debt deductions disallowed by the DDCR prior to the restructure have been accurately calculated
- prior to the restructure, the arrangements would not have attracted the application of Part IVA of the ITAA 1936
- the restructure occurs in a straightforward manner having regard to the circumstances without any associated contrivance or artificiality and is on arm's length terms
- the arrangement following the restructure will not attract the application of Part IVA of the ITAA 1936.

167. If all of these features are present, the restructure will be regarded as a low risk restructure. If any of these features are not present, the restructure will not be regarded as a low risk restructure.

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**Example 12 – repaying debt interest**

168. Aus Co is an Australian tax resident and general class investor, with a wholly owned subsidiary B Co which is a tax resident of Country B.

169. Aus Co identifies debt deductions which are expected to be incurred in the 2024–25 income year that are in relation to acquisitions of CGT assets from an associate pair and financial arrangements used to fund dividends paid to associate pairs that occurred in prior income years.

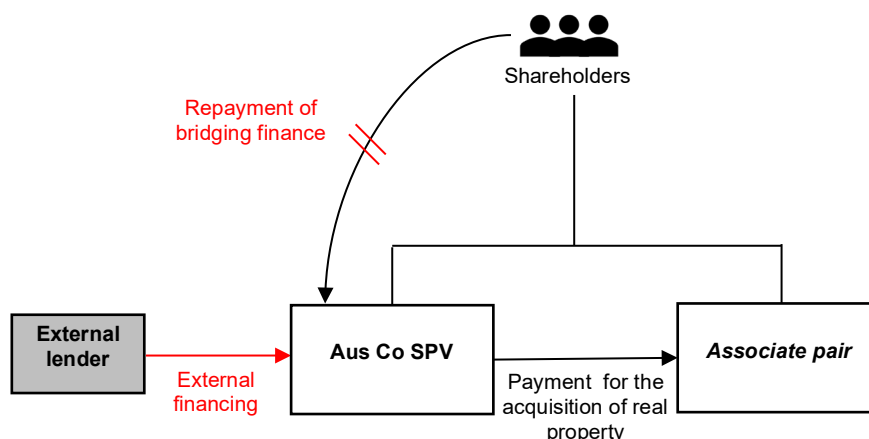
170. Aus Co repays all of the debt interests under which the debt deductions arise from retained earnings and dividends received from B Co.

171. There are no debt deductions arising from its restructured arrangements.

172. This is a low risk restructure.

**Example 13 – repaying bridging finance**

Diagram 12: Repaying bridging finance



173. Assume the facts in Example 6 of this Guideline.

174. Aus Co SPV determines that the DDCR will apply to debt deductions in relation to the acquisition of real property from an associate pair arising from the \$50 million debt interests that Aus Co SPV issued to its shareholders (shareholder debt).

175. Based on contemporaneous documentation and correspondence with financial institutions and intermediaries, the shareholder debt was issued in anticipation of additional external financing being secured by Aus Co SPV to fund the acquisition of the real property. Upon the provision of external financing in October 2024, the \$50 million 'bridging' shareholder debt is repaid by Aus Co SPV.

176. This is a low risk restructure.

177. The use of the shareholder debt as related party bridging finance was commercially necessary and its replacement with external financing always intended and documented.

178. Aus Co SPV will need to consider the correct amount of debt deductions disallowed under the bridging finance due to the operation of the DDCR until it is repaid.

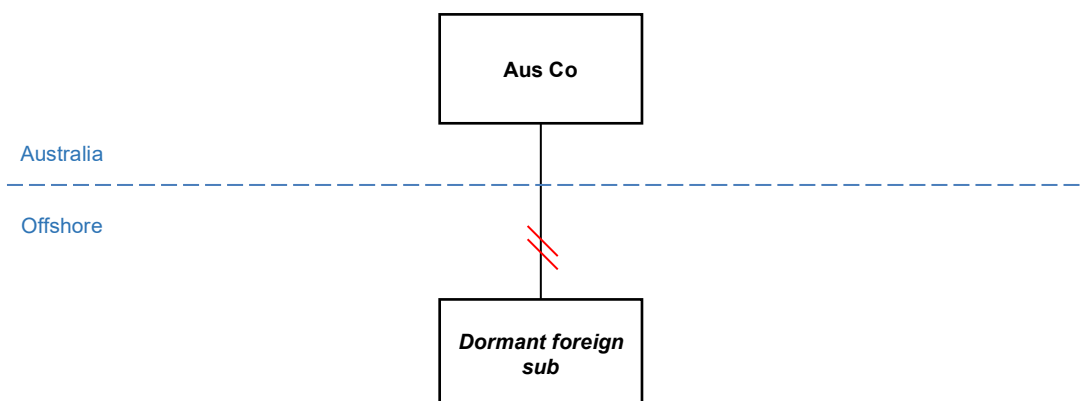
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**Example 14 – disposing of foreign assets**

Diagram 13: Disposing of foreign assets



179. Aus Co is a general class investor that satisfies section 820-37 (known as the 90% Australian assets threshold).

180. Aus Co has a single foreign subsidiary.

181. In anticipation of the DDCR applying, Aus Co liquidates the foreign subsidiary. There is no capital gain or capital loss on the liquidation.

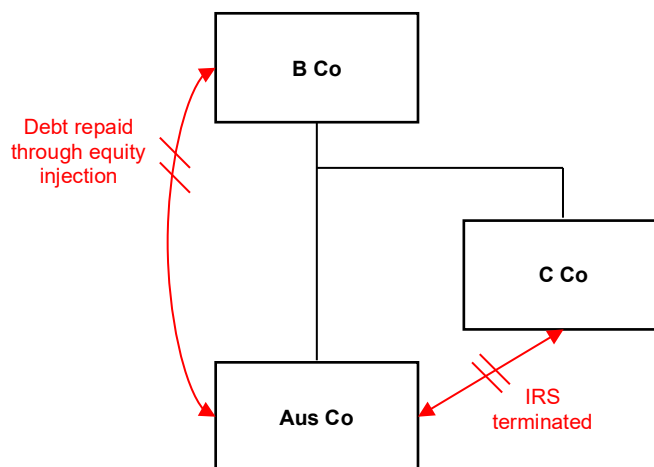
182. In the following income year, Aus Co will no longer be a general class investor.

183. This is a low risk restructure.

184. Aus Co has disposed of a dormant entity and its business operations are not otherwise impacted as a result of the restructure.

**Example 15 – repaying debt interest, terminating swaps, recapitalising subsidiary**

Diagram 14: Repaying debt interest, terminating swaps, recapitalising subsidiary



185. Assume the facts in Example 8 of this Guideline.

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Status: **draft only – for comment**


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186. Aus Co determines that the DDCR will apply to its debt deductions in relation to its purchase of tangible assets from B Co (that is, Aus Co's debt deductions relating to its \$100 million debt issued to B Co and its swap with C Co).

187. Aus Co repays its \$100 million debt, funded by an injection of equity by B Co and terminates the IRS.

188. Subsequently, Aus Co and B Co reconsiders their approach to funding the acquisition of tangible assets and Aus Co is sufficiently capitalised to pay B Co in accordance with its payment terms, preventing potential further related party debt arising through the transfer of assets between the entities.

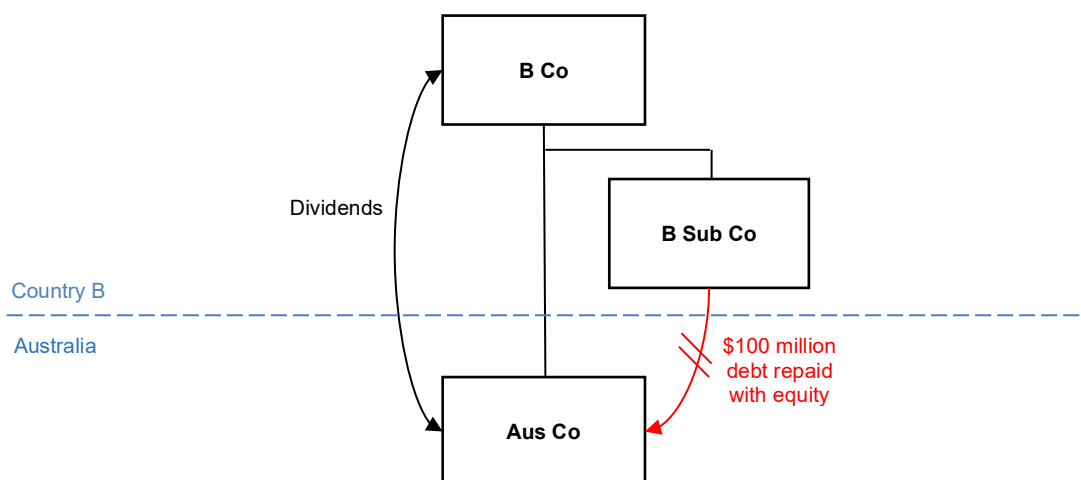
189. This is a low risk restructure.

190. Debt deductions are no longer incurred in relation to the acquisition from an associate pair.

191. Aus Co will need to consider the correct amount of debt deductions disallowed under the arrangement due to the operation of the DDCR until the debt to B Co is repaid and the swap terminated (including any deductible costs arising on termination of the swap).

### **Example 16 – repaying debt interest**

Diagram 15: Repaying debt interest



192. Assume the facts in Example 3 of this Guideline.

193. Aus Co determines that the DDCR would apply to disallow debt deductions in relation to the \$100 million debt interest used to fund the dividends paid to an associate pair.

194. Aus Co repays its \$100 million debt interest held by B Sub Co by issuing additional equity interests to B Co.

195. This is a low risk restructure.

196. Aus Co will need to consider the correct amount of debt deductions disallowed under the \$100 million debt interest due to the operation of the DDCR until it is repaid.

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Status: **draft only – for comment**

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**Example 17 – cash pooling**

197. *Assume the facts in Example 4 of this Guideline.*

198. *Aus Co determines that the DDCR would apply in the 2024–25 income year to disallow debt deductions for the cash pooling arrangement in relation to acquiring CGT assets from associate pairs or funding dividends, royalties and returns of capital to associate pairs.*

199. *During the 2024–25 income year, Aus Co repays its cash pool to a nil balance.*

200. *Subsequently, Aus Co and B Co reconsider funding of Aus Co's transactions with associate pairs and:*

- *B Co increases its capitalisation of Aus Co (through issuing additional equity interests) and annually reviews this arrangement to ensure that Aus Co is sufficiently capitalised to fund Aus Co's relevant transactions and payments with associate pairs.*
- *Aus Co enters into relevant transactions and payments with associate pairs from a separate account or borrowing that is not interest bearing (or used to offset other accounts).*

201. *This is a low risk restructure.*

202. *Aus Co will need to consider the correct amount of debt deductions disallowed for Foreign Co's global cash pooling arrangement due to the operation of the DDCR until Aus Co repays its negative cash pool balance.*

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**High risk restructures**

203. We expect the highest risk restructures would involve arrangements where debt deductions are expected to be disallowed under subsection 820-423A(1) and a similar level of debt deductions are contended to be available under restructured or recharacterised arrangements.

204. For example, higher risk arrangements may include round robin financing, contended change in 'use' of debt under other related party arrangements, or a contrived arrangement to choose and use the TPDT under subsection 820-46(4) with the purported effect of preventing the DDCR from applying.

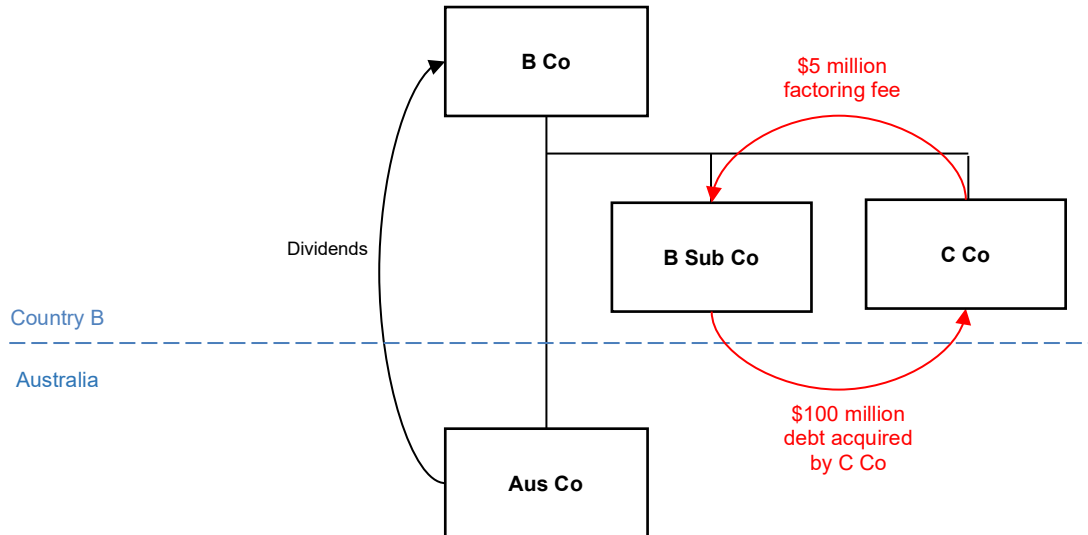
205. The following examples are restructures that are high risk and should be expected to attract intensive compliance action.

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**Example 18 – contending to change the character of costs incurred***Diagram 16: Contending to change the character of costs incurred*

206. Assume the facts in Example 3 of this Guideline.

207. Aus Co determines that the DDCR would apply to disallow debt deductions in relation to the \$100 million debt interest issued by Aus Co to B Sub Co used to fund dividends paid to B Co (an associate pair).

208. B Sub Co enters into a factoring arrangement with C Co, another subsidiary of B Co, which is also a tax resident of Country B. C Co acquires the \$100 million debt interest from B Sub Co at its face value less an agreed factoring fee of 5% of face value.

209. Aus Co contends that the debt deductions for the debt factored by B Sub Co to C Co does not relate to the underlying funding of the dividends paid by A Co to B Co.

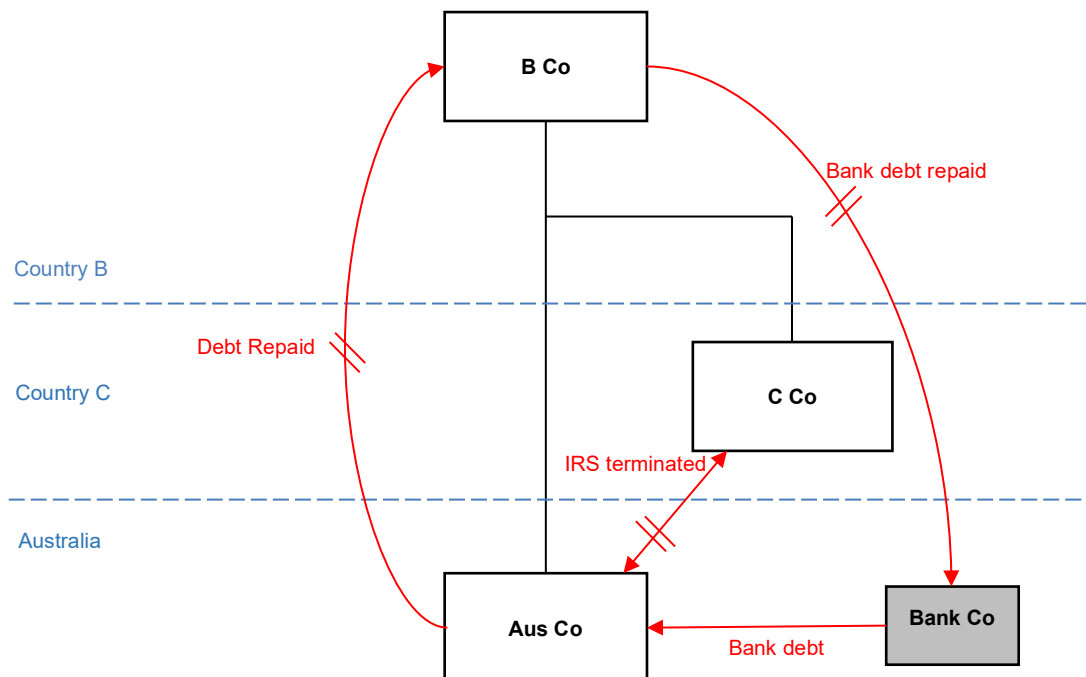
210. This restructure presents risks that the contended change in use does not reflect the underlying arrangement.

211. This is a high risk restructure.

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**Example 19 – replacing related party debt with third-party debt***Diagram 17: Replacing related party debt with third-party debt*

212. Assume the facts in Example 8 of this Guideline.

213. Aus Co determines that the DDCR would apply to its debt deductions in relation to its purchase of tangible assets from B Co (that is, Aus Co's debt deductions relating to its \$100 million debt issued to B Co and its swap with C Co).

214. Aus Co repays its \$100million debt, funded by the proceeds of issuing a \$100 million debt interest to Bank Co.

215. Around the same time B Co repays \$100 million worth of debt owed to Bank Co.

216. This restructure presents risks that the refinancing of related party debt with third-party debt merely has the effect of 'dumping' debt into Australia going forward, with an associated reduction in the third-party debt issued by B Co's offshore group.

217. This is a high risk restructure.



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Status: **draft only – for comment**

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## Your comments

218. You are invited to comment on this Guideline. Please forward your comments to the contact officer by the due date.

219. A compendium of comments is prepared when finalising this Guideline, and an edited version (names and identifying information removed) may be published to the Legal database on [ato.gov.au](http://ato.gov.au).

Please advise if you do not want your comments included in the edited version of the compendium.

**Due date:** 8 November 2024

Contact officer details have been removed as the comments period has ended.

Status: **draft only – for comment**

## References

*Previous draft:*

Not previously issued as a draft

*Legislative references:*

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- ITAA 1997 820-37
- ITAA 1997 Subdiv 820-AA
- ITAA 1997 820-46(4)
- ITAA 1997 820-56
- ITAA 1997 Subdiv 820-B
- ITAA 1997 Subdiv 820-C
- ITAA 1997 Subdiv 820-EAA
- ITAA 1997 820-423A(1)
- ITAA 1997 820-423A(2)
- ITAA 1997 820-423A(2)(a)
- ITAA 1997 820-423A(2)(c)
- ITAA 1997 820-423A(2)(d)
- ITAA 1997 820-423A(2)(e)
- ITAA 1997 820-423A(2)(g)
- ITAA 1997 820-423A(3A)
- ITAA 1997 820-423A(3A)(a)
- ITAA 1997 820-423A(5)
- ITAA 1997 820-423A(5)(a)
- ITAA 1997 820-423A(5)(b)
- ITAA 1997 820-423A(5)(b)(iii)
- ITAA 1997 820-423A(5)(a)(iv)
- ITAA 1997 820-423A(5)(c)
- ITAA 1997 820-423A(5)(f)
- ITAA 1997 820-423A(5A)
- ITAA 1997 820-423A(6)
- ITAA 1997 820-423A(6)(a)

- ITAA 1997 820-423A(6)(b)
- ITAA 1997 820-423A(7)(a)
- ITAA 1997 820-423A(7)(b)
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- ITAA 1997 820-423AA(1)
- ITAA 1997 820-423AA(2)
- ITAA 1997 820-423AA(3)
- ITAA 1997 820-423B(1)
- ITAA 1997 820-423B(2)
- ITAA 1997 820-423D
- ITAA 1997 820-427A(1)
- ITAA 1997 820-427A(3)
- ITAA 1997 995-1(1)
- ITAA 1936 Div 7A
- ITAA 1936 109N
- ITAA 1936 Part IVA
- Treasury Laws Amendment (Making Multinationals Pay Their Fair Share – Integrity and Transparency) Act 2024
- Banking Act 1959

*Other references:*

- Advice under development – international issues
- Supplementary Explanatory Memorandum to the Treasury Laws Amendment (Making Multinationals Pay Their Fair Share - Integrity and Transparency) Bill 2023

## ATO references

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